FILED
JUN 30 2016
CLERK
SUPREME COURT

COMMONWEALTH OF KENTUCKY
SUPREME COURT

FILE NO: 2015-SC-000178-D & 2015-SC-000181-D

KENTUCKY CATV ASSOCIATION, INC.

APPELLANT

vs.

CITY OF FLORENCE, KENTUCKY;
CITY OF WINCHESTER, KENTUCKY;
CITY OF GREENSBURG, KENTUCKY;
CITY OF MAYFIELD, KENTUCKY; AND
KENTUCKY LEAGUE OF CITIES, INC.;
LORI HUDSON FLANERY (IN HER OFFICIAL CAPACITY AS SECRETARY OF THE FINANCE AND ADMINISTRATION CABINET); AND THOMAS B. MILLER (IN HIS OFFICIAL CAPACITY AS COMMISSIONER OF THE DEPARTMENT OF REVENUE)

APPELLEES

REPLY BRIEF OF APPELLANT, KENTUCKY CATV ASSOCIATION, INC.

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CERTIFICATE OF SERVICE

It is hereby certified that a true and correct copy of the foregoing Reply Brief of Appellant, Kentucky CATV Association, Inc. was served by U.S. mail, postage prepaid, this 24 day of June 2016, upon: Bethany Atkins Rice, Office of Legal Services for Revenue, P.O. Box 423, Frankfort, Kentucky 40602-0423; and Barbara B. Edelman, David J. Treacy, and Haley Trogdlen McCauley, Dinsmore & Shohl LLP, 250 W. Main Street, Suite 1400, Lexington, Kentucky 40507.

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STATEMENT OF POINTS AND AUTHORITIES

REPLY TO APPELLEES' COUNTERSTATEMENT OF THE CASE

Appellees, four cities and a non-profit corporation representing member cities ("Cities") battle mightily to morph the Multichannel Video Programming and Communications Services Tax ("Telecom Tax")—what the General Assembly concluded was "an important state interest in providing a fair, efficient, and uniform method for taxing communications services sold in this Commonwealth," KRS 136.600— into a "concocted . . . scheme." App. Br. at 1. But it is a scheme the Cities signed up for, *see* KRS 136.650(1)(b)(1), at least until they did not like the deal they struck. The purported "epic disaster"[1] to their bottom lines is not a constitutional issue (App. Br. at 1); it is one they must address with the General Assembly.[2]

The crux of the Cities' argument is that Sections 163 and 164 guarantee them the "greatest price possible" and that it be received directly from franchisees in the form a local franchise fee, rather than indirectly from the Department of Revenue through a series of state taxes and fees. The Cities concede that neither Section 163 nor 164 explicitly grant any such right, nor even mention franchise fees. *See* KCTA's Main Br. at 14-16. And, instead of rescinding Section 163 as the Cities contend (App. Br. at 1-3, 9), the Telecom Tax Act explicitly provides that Section 163 continues in full force and

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[1] There is no evidence in the record to support the Cities' position that the Telecom Tax resulted in a "disastrous shortfall." App. Br. at 7. For all we know, having divested themselves of the administrative burdens and legal costs of collecting and auditing franchise fees, which the Department of Revenue now shoulders, *see* KRS 136.634, 136.652(1), the Cities could be better off under the Telecom Tax. Nor should the Court accept the Cities' invitation to take judicial notice of data compiled on the Office of the State Budget Director's website (App. Br. at 8 n.8) as evidence of its purported revenue loss, where that data does not reliably reflect the net effect of decreased expenses. *Polley v. Allen*, 132 S.W.3d 223 (Ky. App. 2004) ("The purpose of judicial notice is to 'eliminate the need for formal proof of facts that are beyond the scope of reasonable and legitimate dispute.'").

[2] Beginning in 2007, legislation to increase cities' distributions of Telecom Tax revenues has been introduced annually in the General Assembly at the request of the KLC. The KLC's lobbying efforts stopped only after the KLC changed course and chose to file this suit. *See* H.B. 80 (2007); House Floor Amdt. 17 to H.B. 327 (2007); H.B. 527 (2008); H.B. 341 (2009); H.B. 23 (2010); H.B. 57 (2011); H.B. 33 (2012) (attached as Appendix 2-8).

effect allowing political subdivisions to regulate public utility franchising. KRS 136.660(7).

While the Cities make much ado about the "highest and best bidder" language in Section 164 (App. Br. at 1-2), that language does not limit the General Assembly's retained authority. The Cities concede the bidding requirement was to prevent corrupt city officials from giving away franchises to their cronies, not to limit the General Assembly's retained powers over franchising. App. Br. at 2. Section 164 does not guarantee *anything* and, in fact, it authorizes the rejection of *any* bid and requires consideration of not only the "highest bid," but what is "best."

The Cities also criticize a safeguard intended to protect them in the transition from local collections, describing it as a "calamity." (App. Br. at 7-8). Nonsense. To be sure, the General Assembly designated $3,034,000, as a limit on the "monthly hold-harmless amount" *before* any cities were required to submit historical collections. The Cities claim a "disparity" resulted because the limit falls below the "certified" collections that were displaced, ignoring that *over forty* taxing jurisdictions *increased* franchise fees after passage of the Telecom Tax legislation to increase "historic" collections and shares of the fund.[3] In other words, cities gamed the good faith effort to protect them, and now manufacture a "calamity" the Court can disregard. The only "promise" made by the Telecom Tax was to remit the fixed "monthly hold harmless amount" to the localities. The Cities concede that such payments were in fact made. App. Br. at 18. Thus, the Telecom Tax's "promise" to the Cities was met. The Cities' suggestion that they were

[3] The efforts of franchising authorities to "game" the hold-harmless formula in order to obtain greater distributions are explained in the fiscal impact estimates attached to the 2009-2012 legislation, all of which are available on the Legislative Research Commission's website (www.lrc.ky.gov) and copies of which are attached as Appendix 5-8. *See* KRS 6.950 -- 6.970 (requiring such estimates to be attached before either legislative chamber votes on the bill).

guaranteed to recoup the amount of their historical collections (App. Br. at 7-8)—inflated or otherwise, is belied by the plain language of the statute.

This case is *not* about the Constitution. Sections 163 and 164, and their franchising-related obligations and duties to public utilities and political subdivisions, remain in full force and effect and exist in harmony with the Telecom Tax. So too does Section 181 and its authorization for the General Assembly to delegate to cities or withdraw the power to impose franchise fees. This case is just about money. The Cities want more. The Cities (and other political subdivisions) can seek an increase to the "monthly hold-harmless amount." As discussed in KCTA's main brief and below, however, the Cities' argument, accepted by the Court of Appeals, that the Telecom Tax violates Sections 163 and 164, does not afford the Act its presumption of validity, spurns the General Assembly's retained authority over franchising, and cannot survive reasoned scrutiny. The Court of Appeals decision should be reversed.

ARGUMENT

I. The Court of Appeals Incorrectly Held that the Telecom Tax Violates §§ 163 and 164 of the Kentucky Constitution

As justification for their position that the Court of Appeals correctly held that the Telecom Tax violated Sections 163 and 164, the Cities reiterate their argument that the "highest and best" bid requirement of Section 164, requires that they receive the "greatest price possible," and they suggest that KCTA and the other Appellants are seeking a strained construction of Section 164. App. Br. at 12.

There is no "greatest price" guarantee in Section 164 (or, for that matter, Section 163), so it is the Cities and the Court of Appeals that have placed a strained construction

on Section 164.[4] The constitutional provisions certainly do not prohibit the Commonwealth from collecting the franchise fees on behalf of its political subdivisions, and later doling out some or all of such fees to the localities. Appellants' construction, combined with the "strong presumption of constitutionality" that Acts of the General Assembly enjoy, thus fits easily with the plain language of Sections 163 and 164. *See Holbrook v. Lexmark, Int'l Grp. Inc.*, 65 S.W.3d 908, 914 (Ky. 2002). It is the Cities' heavy burden, moreover, to sustain their contention that the Telecom Tax runs afoul of the Constitution. *Stephens v. State Farm Mutual Auto Ins. Co.,* 894 S.W.2d 624 (Ky. 1995). And they fall far short.

The Cities correctly recognize that the limited purpose of Section 163 was to prevent the Legislature from authorizing indiscriminate use of local rights-of-way (App. Br. at 13), and the purpose of Section 164's bidding process was to prevent localities from giving away their franchise rights by corrupt officials. (App. Br. at 14.) The Telecom Tax neither impacts the right of localities to manage their public rights-of-way (KRS 136.660(7)), nor impacts the localities' right to determine whether to grant a franchise. All that the Telecom Tax does is prohibit direct collection of franchise fees in *exchange for* the right to receive "in lieu of payments" from the State as a proxy for franchise fees, consistent with the General Assembly's exercise of its authority. Neither the letter, nor the spirit (App. Br. at 15) of the Constitution is violated by the General Assembly's action, since the Cities continued to receive "compensation for their valuable

[4] The Cities principally rely on dicta from *Stites v. Norton*, 101 S.W. 1189, 1190 (Ky. 1907), for this proposition, but that Court actually held in that case that a city may foreclose a bidder from submitting the highest bid for a franchise (and, thus, accept a lower price) where it serves Section 164's purpose of promoting competition. *See Stites*, 101 S.W. at 1191.

franchises." App. Br. at 16.[5] Further, although wholly ignored by the Cities and the Court of Appeals, the Telecom Tax provides a substantial benefit to the Cities and other localities by freeing them from the burden of administering franchise fee collections and audits.

The Cities also mischaracterize the impact of the Telecom Tax by suggesting that it could deprive the political subdivisions of *all* monies attributable to their utility franchises. App. Br. at 16. Obviously, under the plain language of the statute, which requires payment of a "monthly hold-harmless amount," that is not the case. KRS 136.650(2)(c). Contrary to the Cities' assertions (App. Br. at 16, 18), public utilities remain required to obtain franchises for using the public rights-of-way, and the bidding requirement and vetting processes remain in place. Neither KCTA, nor the other Appellants ever contended that "the bidding process in § 164 is a mere suggestion, not a requirement." App. Br. at 17.

The Cities tout the purported "shortfall" and reiterate their argument that the Constitution guarantees them the "greatest price possible" (App. Br. at 17, 18) to support their claim that the Telecom Tax violates Sections 163 and 164. However, as discussed above, Section 164 gives them no such guarantee. And they are still able to obtain value from a prospective franchisee in the terms and conditions of their franchises. Additionally, the purported "shortfall" ignores the decrease in administrative expenses and other good and valuable consideration received by the Cities.

Significantly, the Cities acknowledge that the General Assembly has retained authority over franchising, notwithstanding Sections 163 and 164, but quibble over the

[5] Moreover, the General Assembly's withdrawal of its previously delegated power to impose franchise fees simply means that franchise fees can no longer be part of determination of the "highest and best" bid. *See* discussion of Ky. Const. § 181, *infra*.

breadth of that authority. App. Br. at 20-24. They do not (and cannot) quibble, however, that the Constitutional franchise rights are subject to the Commonwealth's police powers (App. Br. at 22), but claim (erroneously) that "the dispute here is about competitive bidding, not police powers." App. Br. at 24. This Court has recognized that "police power" is "as broad and comprehensive as the demands of society make necessary. It must keep pace with the changing concepts of public welfare." *Stephens v. Bonding Ass'n of Ky*, 538 S.W.2d 580 (1976). This case is certainly *not* about competitive bidding, since the cable franchises at issue are not (and cannot) be competitively bid. Under the federal Cable Act, a city cannot deny a franchise to one entity because another offers more benefits. *See* 47 U.S.C. § 541(a)(1) ("[A] franchising authority . . . may not unreasonably refuse to award an additional competitive franchise."). So long as it does not discriminate, it must grant multiple franchises, as a number of Kentucky communities have done. *See id.*

While the Cities correctly contend that the "power to grant franchises as an original proposition inheres in the sovereignty of the state," and is subject to the Commonwealth's right to delegate that power to its political subdivisions (App. Br. at 26), the delegation is limited by its terms. Those terms do *not* include the right to directly receive payments from franchisees, or a guarantee of receiving the "greatest price possible."

II. The General Assembly is Authorized to Provide that Political Subdivisions Receive Amounts As Proxy For Franchise Fees

Since the plain language of Section 181 gives the General Assembly power to collect taxes and fees directly (or delegate those powers to cities), it must follow that Sections 163 and 164 *do not* provide inalienable rights for cities to collect payments from

franchisees. Otherwise, the sections would be irreconcilable. Perhaps recognizing this, the Cities contend that franchise fees for the right to use a city's streets or rights-of-way are not taxes or "license fees on franchise" and are therefore not governed by Section 181. (App. Br. at 26-30.) However, by including within its scope "license *fees* on franchises," Section 181 covers not only taxes, but fees.[7] Further, Section 181 does not limit the type of franchises included within the term "license fees on franchises," and it is beyond question that the grant of the right to occupy a public right-of-way is a franchise. A license, moreover, is simply a grant of permission by a constituted authority. *See, e.g.,* Random House Dictionary (Ballantine 1978); http://thelawdictionary.org/license/ (last visited June 21, 2016). Additionally, the Telecom Tax itself defines "franchise fee or tax" broadly. KRS 136.660(2).

The Cities claim there is a "well-recognized distinction between franchise fees and license fees on franchises" (App. Br. at 27); however, none of the Cities' authorities support any distinction. *See id.* at 28 -29[8]. The Court in *Berea College Utils.* held that a franchise fee "is not a tax" but did not address Section 181 or distinguish a franchise fee from a "license fee on a franchise." The Court in *Patrick* addressed the "license fees on ... trades, occupations and professions" authorized by Section 181, ***not*** license fees on franchises.[9] The Cities have never explained what "license fees on franchises" Section 181 has empowered the General Assembly to authorize for the last 125 years, if not the fees charged by local governments for the right to occupy public rights-of-way. Neither

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[7] This Court recently reaffirmed that the General Assembly may delegate to local governments the power to levy not only taxes but also fees. *See Greater Cincinnati/N. Ky. Apt. Assoc., Inc. v. Campbell Cty. Fiscal Ct.*, 479 S.W.3d 603 (Ky. 2015); *see also Louisville v. Sebree*, 214 S.W.2d 248, 253 (Ky. 1948) (noting that the term "fee" can refer to a fee or a tax).

[8] Citing *Berea College Utils. v. City of Berea*, 691 S.W.2d 235 (Ky. 1985) and *Patrick v. City of Frankfort*, 539 S.W.2d 275 (Ky. 1976).

[9] *See* App. Br. at 28-29, citing *Mitchell v. Knox Cnty. Fiscal Ct.*, 177 S.W. 279 (Ky. 1915).

has the Cabinet.[10] The reason is clear. There is no "well-recognized distinction": franchise fees and "license fees on franchises" are one in the same. The Cities' unsupported claim that for the last 125 years Section 181 has authorized some other, yet-to-be-recognized fee simply fails.[11] Resort to Section 181 may not be necessary if this Court agrees that the Telecommunication Tax does not violate Sections 163 and 164. Section 181 nevertheless provides express authority for the General Assembly to authorize or, as it has done here, to withdraw the Cities' power to collect franchise fees.

III. Section 171 of the Kentucky Constitution and the Equal Protection Clause Must Be Considered in Determining Whether the Court of Appeals' Decision Should Be Overturned

The Cities' statement that KCTA's argument that striking down the Telecom Tax will result in violations of the Uniformity and Equal Protection Clauses of the Kentucky and United States Constitutions "is a red herring," (App. Br. at 30), is just wrong. Constitutional violations are never "red herrings."

While *Insight Kentucky Partners II, L.P. v. Commonwealth*, No. 01-CI-01528 (Franklin Cir. Ct. Jan. 30, 2004), is not binding on this Court, it motivated the enactment of the Telecom Tax by holding that KRS 136.120 violated Section 171, *i.e.*, Kentucky's Uniformity Clause, because it resulted in satellite companies and cable companies being treated differently. Although the Cities argue that the case is irrelevant because property taxes were involved, the Cities acknowledge that "license fees" must also observe "the

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[10] See Cabinet Brief at 17. The Cities also seem to believe—erroneously—that all parties on the same side of litigations must agree on legal arguments and positions. While there are instances where the Cabinet and KCTA may not be on all fours, it is the legal strength of the argument that governs its merit, not what another aligned party may or may not argue.

[11] The Kentucky Attorney General has twice recognized Section 181 and statutory delegations of authority under Section 181 as the authority for cities to impose franchise fees. In Ky. Atty. Gen. Op. 83-233, the Attorney General opined that a city's imposition of a franchise fee on an electric utility was authorized by Section 181 as delegated to the city by KRS 92.281. Section 181 and KRS 92.281 are similarly cited as authority for city franchise fees in Ky. Atty. Gen. Op. 82-34.

principle of equality and uniformity." App. Br. at 32. As discussed above, license fees on franchises are synonymous with "franchise fees."

Although the Cities maintain that cable companies need not be treated similarly to satellite companies with respect to franchise fees, since cable companies use the public rights-of-way, the Cities fail to recognize that the General Assembly made a reasoned decision to collect a uniform tax on communications providers, regardless of the "myriad of levies, fees and rates imposed at all levels of government." KRS 136.600(2), (3). Further, the court in *Insight Kentucky Partners* rejected the argument that cable companies' use of public rights-of-way warranted a different taxing method.

If the Court of Appeals decision is not reversed by this Court, Telecom companies would again find themselves being taxed differently depending on whether they were delivered by wire or by a method other than wire. Challenges to the lack of uniformity and equal treatment and protection will likely find themselves in the litigation limelight. Kentucky consumers of communications services would again be unable to make tax neutral decisions regarding their telecommunications services.

IV. The Court of Appeals Decision Should Be Reversed Because it is Incorrect, but its Affirmance Will Unquestionably Generate A Multitude of Serious Issues

KCTA agrees with the Cities that confusion and uncertainty are not adequate bases to uphold a tax if the tax is unconstitutional. App. Br. at 34. But, as discussed in KCTA's main brief and herein, the Telecom Tax is constitutional. KCTA does not, agree, however, that no confusion and/or uncertainty would ensue if the Court of Appeals decision is not overturned.

The Cities' argument that it does not seek to invalidate the entire Telecom Tax as unconstitutional fails to appreciate that the Court of Appeals found the Telecom Tax to be

"unconstitutionally void." Finding a tax to be "unconstitutionally void" is *not* a "surgical" invalidation as alleged by the Cities. App. Br. at 35. Further, the purportedly offending provisions cannot be excised from the Telecom Tax because doing so would "interfer[e] with the just and proper working out of the general purposes of the act." 16A Am. Jur. 2d, *Constitutional Law,* § 209 (2012). The purposes of the Telecom Tax could not be met under a "surgical" approach, because there would no longer be a uniform and simplified method for taxing communications services *See, e.g.,* KRS 136.600; 136.660(1); *St. Ledger v. Revenue Cabinet*, 942 S.W.2d 893, 896-97 (Ky. 1997)(rejecting such surgical approach when contrary to expressed legislative intent). Additionally, the Cities' notion that the potential retroactivity of the Court of Appeals decision is a "scare tactic[ ]" (App. Br. at 35, n.19), fails to recognize this Court's own view. *Branham v. Stewart*, 307 S.W.3d 94, 102 (Ky. 2010).

CONCLUSION

For the reasons stated herein and in KCTA's main brief, this Court should reverse the decision of the Court of Appeals.

Respectfully submitted,

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